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## THE POWER OF A CORPORATION TO ACQUIRE ITS OWN STOCK

There are two general views of corporate capacity. The first view regards a corporation as possessed of general capacity, by which is meant that the corporation may do anything that a natural person can do, unless the act is either expressly or impliedly prohibited by its charter.<sup>1</sup> This theory has met with little favor in the United States. In this country, the doctrine of special corporate capacity has been almost universally adopted.<sup>2</sup> Under this view, a corporation possesses only the powers conferred upon it in its charter, together with those powers which are incidental to, or consequential upon, or reasonably necessary for effectuating the main powers conferred. And in the case of the ordinary private corporation, American courts are inclined to take a liberal view of its powers, inclining more and more to hold that if the sovereign state does not intervene, there is no valid reason for confining the operations of the ordinary private corporation too closely.<sup>3</sup>

Implied powers are presumed to exist to enable corporate bodies to carry out the express powers granted, in order adequately to accomplish the purposes of their creation. Suppose no express power is conferred upon a corporation to acquire

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<sup>1</sup> *South Yorkshire R. Co. v. Great Northern R. Co.*, 9 Exch. 84. But see *Ashbury Railroad Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 653.

<sup>2</sup> *Thomas v. West Jersey R. Co.*, 101 U. S. 71; *Franklin Bank v. Commercial Bank*, 36 Oh. St. 350.

<sup>3</sup> See *Harris v. Independence Gas Co.*, 76 Kans. 750, *Canfield & Wormser's Cases on Priv. Corps.*, 337.

its own shares. The question arises whether the corporation may make such a purchase or whether it is outside of and beyond the limit of its powers. Perhaps on no subject in the law of corporations is there more conflict of authority.<sup>4</sup>

At the outset it seems necessary to distinguish two much abused terms, namely, "Power" and "Right." Much difficulty arises from the unfortunate use by courts of the term "Power." In the last analysis, a corporation has *power* to do almost anything. The question is not so much whether it has the *power* to do the act, as to whether it has the *right* to do the act. A and B enter into a contract. A assuredly has the *power* to break the agreement, but that does not give A the *right* to break it, Mr. Justice Holmes notwithstanding. Suppose a corporation is organized to purchase and sell groceries at retail. It has the *might*, it has the *power*, but surely not the *right* to purchase and operate a circus and menagerie. Yet, courts speak illogically of the want of corporate *power* to purchase the circus and menagerie. The terminology misleads and confuses. There can be no question but that a corporation has the *power* to acquire its own shares. No well considered case in any jurisdiction should question this. The issue is solely one as to the *right* of the corporation to do so.

On the question of right, there exist two lines of decisions. One line enunciates what may be termed the English rule; the other what may be termed the American rule. The English view regards the purchase as *ultra vires*, unless the corporation has been expressly authorized to buy its own shares. The leading case of *Trevor v. Whitworth*<sup>5</sup> assigns two main reasons for this conclusion. First, it is said that if the corporation acquires its shares with a view to selling them again, this is an unauthorized speculation in its own stock, amounts to a trafficking in its shares, and is *ultra vires*. On the other hand, if it is not intended to reissue and part with the shares, then the purchase amounts to an invalid and unauthorized reduction of its own capital stock. It is insisted that the dilemma is perfect, and that in either event, the purchase of its own stock is unlawful. Quoting Lord Herschell:

"What was the reason which induced the company in the present case to purchase its shares? If it was that

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<sup>4</sup> 27 Harv. Law Rev. 747; 14 Col. Law Rev. 451.

<sup>5</sup> 12 Appeal Cases 409. And see, *Hope v. International Financial Society*, 4 Ch. Div. 327.

they might sell them again, this would be a trafficking in the shares, and clearly unauthorized. If it was to retain them, this would be to my mind an indirect method of reducing the capital of the company."

Neither of these reasons is altogether convincing. Nobody would question the right of a corporation to sell shares of its own stock which it acquired, for example, by gift<sup>6</sup> or by bequest.<sup>7</sup> Nobody would question the right of a corporation to part with shares of its own stock which it had taken in payment of an antecedent indebtedness.<sup>8</sup> Yet, this, too, would be trafficking in the corporation's own shares. Under a reasonably fair (not liberal) view of corporate powers,<sup>9</sup> there seems no adequate reason for objecting to this in the absence of facts and circumstances tending to show fraud or impropriety. With regard to the argument that the purchase is an indirect method of reducing the corporate capital stock, it is a sufficient answer to point out that the purchase is not necessarily a reduction.<sup>10</sup> The shares are simply retired for the time being and may be reissued at will. Quoting Judge Danforth of the Court of Appeals of New York:<sup>11</sup>

"In some way it (the corporation) had become the owner of these shares, not for the purpose of diminishing its capital stock, but for enjoyment as property. As such they stood upon its books, until in the regular transaction of business the stock was transferred to Conkling. The company had a right to hold it *unextinguished*, and a right to *reissue* it."

This also answers the contention of the authorities and text writers who insist that a purchase by a corporation of its own

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<sup>6</sup> *Lake Superior Co. v. Drexel*, 90 N. Y. 87.

<sup>7</sup> *Rivanna N. Co. v. Dawson*, 3 Gratt. (Va.) 19.

<sup>8</sup> *Coppin v. Greenless & Ransom Co.*, 38 Oh. St. 275.

<sup>9</sup> As to what is the appropriate test for construction of implied powers, see the opinion of Vice Chancellor Bacon in *London Financial Assn. v. Kelk*, 26 Ch. Div. 107, 134, Canfield & Wormser's Cases, 205, note.

<sup>10</sup> *Western Imp. Co. v. Des Moines Nat. Bk.*, 103 Iowa 455; *City Bank of Columbus v. Bruce*, 17 N. Y. 507; *State v. Smith*, 48 Vt. 266; *Howe Co. v. Jones*, 21 Tex. Civ. App. 198. In this regard, Morawetz, and Machen who follows Morawetz, seem to err. Morawetz, *Priv. Corps.* (2nd ed.), sec. 112; Machen, *Modern Law of Corps.*, sec. 626. And see, 27 Harv. Law Rev., 748-749, for a correct appreciation of the situation.

<sup>11</sup> *Vail v. Hamilton*, 85 N. Y. 453, 457-8.

shares is an unlawful method of reducing the capital stock, not being the method provided for by law.<sup>12</sup> The flaw in the argument lies in the assumption that a purchase of its own shares must necessarily involve a reduction of capital stock.

Another argument advanced in support of the English doctrine is that the purchase of its own stock by a corporation operates necessarily as a fraud upon creditors who deal with the corporation on the faith that the capital stock is paid up.<sup>13</sup> A recent text writer<sup>14</sup> thus voices it:—

"It is no answer to say that if the company is thoroughly solvent, so that its assets after the purchase are still amply sufficient for payment of all claims against it, the creditors are not prejudiced. For, while the assets may still remain sufficient, yet they are after the consummation of the purchase, undeniably less by the amount of the purchase money than they were before; and hence the fund which the creditors had an *absolute right* to have preserved intact for the payment of their claims, has been diminished without their consent."

This argument involves several fallacies. Suppose no creditors exist. Then, of course, the argument fails utterly. If there are no creditors, how can creditors be injured? Suppose however, that there are creditors, but the purchase of its own shares is made from a goodly *surplus* which the company has been accumulating.<sup>15</sup> Surely nobody would contend that the corporate surplus is a fund "which its creditors had an *absolute right* to have preserved intact for the payment of their claims." That creditors must be injured by the corporate purchase of its own stock, does not necessarily follow, and consequently the rights of creditors furnish no conclusive argument in support of the English doctrine. If creditors are injured by such a purchase, they can be amply protected without going to the extreme—quite unnecessary in order to protect them—of denying to a corporation the right ever to acquire its own shares.<sup>16</sup>

<sup>12</sup> Thus see, M'Sherry, C. J., in *Maryland Trust Co. v. Nat. Mech. Bk.*, 102 Md. 608, especially 623-626.

<sup>13</sup> *Trevor v. Whitworth*, *supra*; *Maryland Trust Co. v. Nat. Mech. Bk.*, *supra*; 2 Thomp., Corps., sec. 2,054 (erroneous "trust fund" argument).

<sup>14</sup> Machen, *Modern Law of Corps.*, sec. 626.

<sup>15</sup> See *Hamor v. Taylor-Rice Engineering Co.*, 84 Fed. 392: "Was the money which the defendant undertook to pay him for his surrender of stock to come out of any surplus or fund of net profits, on the one hand, or on the other, out of the fund represented by the capital stock?"

<sup>16</sup> *Clapp v. Peterson*, 104 Ill. 26.

It is also urged that to permit a corporation to acquire its own shares results unjustly since it increases the relative voting strength of large stock holders, and results in giving undue power to the majority.<sup>17</sup> If no fraud or bad faith on the part of the majority appears, this argument fails completely, and it is elementary that if fraud or bad faith do appear, the minority may obtain ample and adequate relief.<sup>18</sup> If abuse results, the abuse should be stifled. But the corporation should not be unduly hampered by laying down the arbitrary rule of non-acquisition of its own shares, irrespective of good or bad purpose, object and result.

Finally, the argument has been made that, viewed from the theoretical standpoint, the acquisition by a corporation of its own shares is anomalous. "It is inconsistent with the essential nature of a company that it should become a member of itself."<sup>19</sup> And it is insisted that is precisely what a corporation does when it acquires its own stock.<sup>20</sup> Whatever validity this argument may have, the courts following the English doctrine seem estopped to assert it, since all of them permit a corporation to take over its own stock in satisfaction of a debt due to it.<sup>21</sup> In such instances, the theoretical inconsistency is ignored by them, perhaps upon the assumption that necessity knows no law,—a practical view, but a trifle illogical.

In the United States, several jurisdictions including Kansas, Maryland, Missouri, New Hampshire, Ohio and Tennessee, follow the English doctrine and deny that the right to acquire its own shares should be implied as a corporate power.<sup>22</sup> National banks are forbidden by express statute to buy their

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<sup>17</sup> Machen, *Modern Law of Corps.*, sec. 626.

<sup>18</sup> As to powers of majority and rights of minority, see *Canfield & Wormser's Cases*, 704-726. See also, *Lowe v. Pioneer Threshing Co.*, 70 Fed. 646.

<sup>19</sup> *In re Dronfield Silk Stone Co.*, 17 Ch. Div. 83. For a similar Continental point of view, see H. Staub, *Kommentar zum Handelsgesetzbuch* (7th ed.) I, p. 679.

<sup>20</sup> *Maryland Trust Co. v. Nat. Mech. Bk.*, 102 Md. 608, 623-6.

<sup>21</sup> See *Canfield & Wormser's Cases*, 214, note.

<sup>22</sup> *German Sav. Bk. v. Wulfekubler*, 19 Kans. 65; *Maryland Trust Co. v. Nat. Mech. Bk.*, 102 Md. 608; *St. Louis Carriage Mfg. Co. v. Hilbert*, 24 Mo. App. 338; *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *State v. Oberlin Bldg. & Loan Assn.*, 35 Oh. St. 258; *Cartwright v. Dickinson*, 88 Tenn. 476. In many cases cited as supporting the English doctrine, including some of the above, the language is *obiter*.

own shares.<sup>23</sup> In England, "the Stock Exchange will not grant a settling day, or allow a quotation to any company which purports to have the power of buying its own shares."<sup>24</sup> In Germany, the Commercial Code (Sect. 226) forbids private corporations from acquiring their own shares either in the course of business or in pledge. Shares may not even be purchased out of surplus. The only exception is where the purchase of shares is necessary to carry out plans of retirement or amortization. Even this must have been stipulated for in the articles of association.<sup>25</sup> The motive of the German provision has been regarded as twofold: "First, because it is repugnant to legal concepts that a corporation be its own shareholder, and secondly, because the provision tends to prevent speculation in the shares of the corporation by its officers and managers, who might thus obtain unfair advantages on the credit of the organization."<sup>26</sup>

In England and in American jurisdictions, which follow the English view, an exception to the rule that a corporation cannot traffic in its own stock, is admitted to exist, whereby the corporation is allowed to take its own stock as collateral,<sup>27</sup> or to effect a compromise of a disputed claim against a stockholder,<sup>28</sup> or in satisfaction of a debt due to the corporation.<sup>29</sup> "This exception is supposed to rest on a necessity which arises in order to avoid loss."<sup>30</sup> It seems proper to say that several early cases only held this limited proposition, but have been apparently used as authorities for the broad proposition of a general right to acquire. Thus, in *Taylor v. Miami Exportation Company*,<sup>31</sup> it was held in Ohio that a banking corporation might lawfully

<sup>23</sup> Rev. St. U. S., sec. 5201.

<sup>24</sup> *Per* Lord Macnaghten in *Trevor v. Whitworth*, *supra*.

<sup>25</sup> German Comm. Code, sec. 227. And even then, the purchase may only be made out of the corporate surplus.

<sup>26</sup> Kuhn, A Comparative Study of the Law of Corporations, p. 123 (Columbia Univ., Studies in History, Economics and Public Law, vol. XLIX, no. 2).

<sup>27</sup> *Williams v. Savage Mfg. Co.*, 3 Md. Ch. 452.

<sup>28</sup> *State v. Oberlin Bldg. & Loan Assn.*, *supra*; *Morgan v. Lewis*, 46 Oh. St. 1.

<sup>29</sup> *First Nat. Bk. v. Nat. Exch. Bk.*, 39 Md. 600; *Maryland Trust Co. v. Nat. Mech. Bk.*, *supra*; *Taylor v. Miami Exp. Co.*, 6 Ohio 176; *Coppin v. Greenless & Ransom Co.*, 38 Oh. St. 275, 279; *Morgan v. Lewis*, *supra*. See also, Canfield & Wormser's Cases, 214, note.

<sup>30</sup> McIlvaine, J., in *Coppin v. Greenless & Ransom Co.*, *supra*.

<sup>31</sup> 6 Ohio 176.

receive shares of its own stock from a solvent debtor in discharge of his indebtedness. In the early New York case, *City Bank of Columbus v. Bruce*,<sup>32</sup> it appeared that the board of directors of a banking corporation passed a resolution that all stockholders indebted to the bank on stock notes might pay such debts to the bank in its shares of stock at a named percentage, and that almost one-half of the stock of the bank was so surrendered. The Court of Appeals held, following the Ohio case, that there was "no ground for questioning the validity of this transaction." These two cases, at a later day, seem to have been used as authority in support of much more than they actually hold.<sup>33</sup> Even national banks may take shares of their own stock "to prevent loss upon a debt previously contracted in good faith."<sup>34</sup>

The general American rule, in support of which is the decided weight of authority, affirms that a corporation has implied power to take its own shares, provided it does so in good faith and without any injury to its creditors or stockholders.<sup>35</sup> The underlying reason for the American doctrine, as it may be termed, seems to be the feeling on the part of most American courts that the English doctrine is far too narrow and rigid and unduly ignores customary business demands. Thus, under the doctrine of England, as has been seen, a purchase by a corporation of its own shares is *ultra vires*, (1) Even though *bona fide*; (2) Even though all the stockholders consent; (3) Even though there is no defrauding of, or intent to defraud, creditors.

The American doctrine, however, carefully safeguards the

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<sup>32</sup> 17 N. Y. 507.

<sup>33</sup> Thus see *Chicago etc. R. Co. v. President etc. of Marseilles*, 84 Ill. 643, Canfield & Wormser's Cases, 209. Cf. Angell & Ames, Corps., sec. 280.

<sup>34</sup> Rev. St. U. S., sec. 5201.

<sup>35</sup> *Dalton Grocery Co. v. Blanton*, 8 Ga. 809; *Clapp v. Peterson*, 104 Ill. 26; *Dupee v. Boston Water Power Co.*, 114 Mass. 37; *Porter v. Plymouth Gold Mining Co.*, 29 Mont. 347; *Chapman v. Iron Clad Rheostat Co.*, 62 N. J. L. 497 (statutory provision); *City Bank of Columbus v. Bruce*, *supra*; *Vail v. Hamilton*, *supra*; *Moses v. Soule*, 63 Misc. Rep. (N. Y.) 203, 118 N. Y. Supp. 410; *Adam v. New Eng. Inv. Co.*, 33 R. I. 193; *San Antonio Co. v. Sanger*, 151 S. W. (Tex. Civ. App.) 1104; *State v. Smith*, 48 Vt. 266; *U. S. Mineral Co. v. Camden*, 106 Va. 663; *Gilchrist v. Highfield*, 140 Wis. 476; *In re Castle Braid Co.*, 145 Fed. 224. See also, *Chicago etc. R. Co. v. President etc. of Marseilles*, 84 Ill. 643, for a review of the early authorities.



exercise of this right. As said by the Supreme Court of Illinois:—<sup>36</sup>

“If it was shown that the purchase was made to promote the interests of the officers of the company alone, and not the stockholders generally, or if for the benefit of a portion of the stockholders and not all, or for the injury of all or only a portion of them, or if operated to the injury of creditors, or would defeat the end for which the body was created, or if it was done for any other fraudulent purpose, then chancery could interfere.”

The American doctrine fully recognizes that the exchange of corporate property or cash for shares of its own stock, and cancelling the stock, furnishes no equivalent for creditors. It must not be supposed that this is not recognized, for it is. The purchase must be in good faith and will only be upheld provided it is made without intent to injure creditors and stockholders and provided they are not, in fact, injured thereby.<sup>37</sup>

Some of the criticism leveled at the prevailing doctrine apparently seems based upon the assumption that the corporate majority may vote the shares acquired. The law, however, is well settled that a corporation may not vote shares of its own stock held by it, either directly or indirectly by a trustee.<sup>38</sup> Suppose Corporation A acquires all the shares of stock of Corporation B; suppose Corporation B acquires 10 shares of stock in Corporation A; may Corporation B, through its accredited agent for that purpose, vote the 10 shares of stock which it owns in Corporation A at a meeting of the stockholders of Corporation A? Is this a voting by Corporation A of its own shares of stock? It seems clear that on principle, Corporation B should have the right to vote its 10 shares, under the prevailing and orthodox entity doctrine. Corporation B is a distinct and separate legal personality and juridical body from Corporation A. *Non sequitur*, if Corporation B were organized or the stock transfers made, solely in order to attain certain desired voting results, that the veil of entity might not be pierced, especially if an improper or fraudulent purpose appeared. It must not be

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<sup>36</sup> *Chicago etc. R. Co. v. President etc. of Marseilles*, *supra*, Canfield & Wormser's Cases, 209, 211.

<sup>37</sup> *Clapp v. Peterson*, *supra*.

<sup>38</sup> *Amer. R. Frog Co. v. Haven*, 101 Mass. 398; *Ex parte Holmes*, 5 Cow. (N. Y.) 426. See also, Cook, Corps. (7th ed.), sec. 613.

supposed that the doctrine of corporate entity can be employed as a species of legal whitewash.<sup>39</sup>

Several situations present themselves under the prevailing American doctrine. First, suppose the contract of purchase is made and payment completed while the corporation is solvent. Under such circumstances, on principle it should be held that even though insolvency *thereafter* ensues, the trustee in bankruptcy should not be permitted to recover the corporate payments.<sup>40</sup> Even in jurisdictions which follow the English doctrine, the contract of purchase, although *ultra vires*, being consummated, should not be disturbed. On the other hand, in the very few jurisdictions which hold that it is not only *ultra vires* but *illegal* and *against public policy* as well for a corporation to acquire its own shares, the contract though fully consummated seemingly may be repudiated and the consideration recovered back.<sup>41</sup> The distinction between regarding the purchase as *ultra vires* and as *illegal*, is obvious.<sup>42</sup> Suppose a corporation organized to run a retail groceries business contracts to purchase two performing elephants. By no stretch of the human imagination could this be called an illegal act, an act *contra bonos mores*. At most, the purchase is simply unauthorized, that is to say *ultra vires*.

Second, suppose the contract is made when the corporation is insolvent. Under such circumstances, the purchase is clearly invalid, under either the English or the American doctrine, since it jeopardizes the capital stock and diminishes the fund to which creditors would naturally look.<sup>43</sup> On elementary principles of the law of fraud, the transaction should be vitiated.

Third, suppose the contract of purchase is made when the corporation is solvent, but the payment of the purchase price for the shares would cause insolvency. This transaction also

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<sup>39</sup> See my paper, "Piercing the Veil of Corporate Entity," 12 Columbia Law Rev. 496, *et seq.*

<sup>40</sup> *Joseph v. Raff*, 82 N. Y. App. Div. 47, *affd.* short, 176 N. Y. 611. See also *Tierney v. Butler*, 144 Iowa 553.

<sup>41</sup> *Crandall v. Lincoln*, 52 Conn. 73. *Sed qu.*

<sup>42</sup> But the Supreme Court of the United States seems repeatedly to have overlooked this distinction. Thus see, *Central Transportation Co. v. Pullman's Palace Car Co.*, 139 U. S. 24; *St. Louis, Vandalia & Terre Haute R. Co. v. Terre Haute & Indianapolis R. Co.*, 145 U. S. 393. And so have many other authorities. See Canfield & Wormser's Cases, Chap. V, sec. 3, *passim*.

<sup>43</sup> *Hall v. Alabama etc. Co.*, 173 Ala. 398; *Tiger Bros. v. Rogers etc. Co.*, 96 Ark. 1; *Alexander v. Relfe*, 74 Mo. 495; *Currier v. Lebanon Slate Co.*, 56 N. H. 262.

should be condemned; and the contract regarded as unenforceable since fraudulent to creditors.<sup>44</sup> The creditors of a corporation which is being wound up, and who have a natural right to look to paid up capital as the fund out of which their debts are to be discharged, should not be forced to come into competition with stockholders in the company who claim that the company is bound to pay them a part of the capital. The transaction is inchoate and the court should not be forced to compel its completion.

Fourth, suppose the contract of purchase is made when the corporation is solvent, but the corporation becomes insolvent before payment is made or completed. Here again, the transaction is inchoate. This situation was considered by the United States Circuit Court of Appeals for the Second Circuit, in a recent decision.<sup>45</sup> A New York corporation while solvent purchased certain shares of its own stock giving a note for the purchase price. When the note given in payment matured, the corporation was insolvent. It was held unanimously that payment of the note should be postponed until after the claims of general creditors had been satisfied. In other words, if at the time the stockholder is to receive payment for the shares of stock which he has sold, the payment by the corporation would prejudice its creditors, payment cannot be enforced. On principle and as a common law proposition this holding is sound, since in no jurisdictions, English or American, should a corporation ever be permitted to consummate a purchase of its own shares where this might work a detriment or injustice to creditors. Even though the corporation is solvent when the agreement is made, the law should attach the condition that payment cannot be enforced if to enforce payment would deprive the creditors of assets.

Judge Rogers, in his opinion, found it unnecessary to pass upon the case as a common law proposition because of the express statutory provision in New York, which declares guilty of a misdemeanor any directors who vote "to apply any portion of the funds of a corporation, except surplus profits, directly or indirectly, to the purchase of shares of its own stock." (Penal Law of New York, section 664, subd. 5.) Quoting from the opinion:

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<sup>44</sup> *Atlanta Assn. v. Smith*, 141 Wis. 377. See also, 2 Va. Law Rev., at p. 74. Cf. *Trevor v. Whitworth*, *supra*.

<sup>45</sup> *In the matter of Feckheimer Fishel Co., Bankrupt*, 212 Fed. 357 (1914), opinion *per Rogers*, J.

"But we are not by any means to understand that a corporation has a right to buy its own stock, simply because it is solvent at the time, because if it becomes insolvent thereafter and before payment has been made, or if it is made insolvent by the transaction, the payment cannot be made, for the Penal Law of the State makes it a crime to apply anything but 'surplus profits' to the purchase of the stock and there are no such profits which can be applied."

One recent criticism of the decision<sup>46</sup> fails to refer to the statutory prohibition upon which the decision is rested. Another<sup>47</sup> doubts "that the legislature intended by a provision contained in the penal law to impose such a limitation upon the power of the corporation as delineated in the corporation law." This criticism fails to cite, apparently overlooking, the decision of the Court of Appeals of New York upon the applicability of this provision.<sup>48</sup> The action therein was brought upon a contract made by a corporation to purchase its own stock. The action was defended by the corporation upon the ground that the contract was not enforceable by reason of the provisions of section 664 of the Penal Law, making it a misdemeanor for directors to apply any of the funds of a corporation, except surplus profits, to that purpose. The court held that the burden of proof was upon the corporation of showing that there were no surplus profits out of which the purchase could be made. It is obvious that the court assumed that the purchase of shares of its own stock out of capital stock would be improper. The Court of Appeals said:—

"The contract itself, therefore, was perfectly legal subject to certain limitations upon its enforceability. *If when the time came it had a sufficient surplus, the contract would be enforced.*"

It follows that certainly under the New York statute, as interpreted by the New York courts, if not indeed as a common law proposition, the federal decision is sound. Its tendency is commendable, since jurisdictions which permit a corporation to acquire its own stock should, and do, carefully safeguard the rights of creditors as primary and supreme.<sup>49</sup>

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<sup>46</sup> 27 Harvard Law Rev., 747-750.

<sup>47</sup> 14 Columbia Law Rev., 451.

<sup>48</sup> *Richards v. Ernest Wiener Co.*, 207 N. Y. 59 (1912), aff'g. 145 App. Div. 353.

<sup>49</sup> *Clapp v. Peterson*, *supra*. But cf. *Cole v. Cole Realty Co.*, 169 Mich. 347.

One factor overlooked by many decisions dealing with this subject is the practical distinction, as obvious to business men as it should be to the courts, and plainly recognized by the New York statute, between a purchase of its own shares by a corporation out of *capital*, and a similar purchase out of *surplus*. Where the purchase is made from surplus, it is difficult to see how creditors can be injured, and if the corporation as a whole is benefited by the purchase, there seems no valid reason for forbidding the directors to employ the corporate surplus in this manner.<sup>50</sup>

On principle, a purchase by a private corporation of its own shares from surplus, should be upheld by the courts,

- (1) Provided a legitimate and proper corporate object is advanced.
- (2) Provided the condition of corporate affairs warrants it.
- (3) Provided the transaction is designed and carried out in entire good faith.
- (4) Provided the corporation receives full and clear value.
- (5) Provided there is intended and there results no undue advantage to a few favored stockholders at the expense of the remainder.
- (6) Provided the rights of creditors are not jeopardized.

If the rights of creditors and the rights of stockholders are thus safeguarded, and if purchase be permitted from surplus alone as distinguished from capital stock, there would seem no valid reason for denying to a corporation the right to acquire shares of its own stock.<sup>51</sup> On the contrary, to deny the right under such conditions and circumstances, would unduly hamper corporate activity and usefulness and the serviceability of the private corporation as a type of business organization.

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<sup>50</sup> See *Lowe v. Pioneer Threshing Co.*, 70 Fed. 646, *semble*; *Clark v. E. C. Clark Machine Co.*, 151 Mich. 416. In *Hamor v. Taylor-Rice Engineering Co.*, 84 Fed. 392, the burden of proof was placed upon plaintiff, the vendor, to show a surplus. Cf. *Richards v. Ernest Wiener Co.*, *supra*, where the New York court held the burden to be upon the corporation, the vendee, to prove that there was no surplus out of which the purchase of its shares could lawfully be made.

<sup>51</sup> See *Price v. Pine Mt. Iron Co.*, 32 S. W. (Ky. Ct. App.) 267.